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Economics Group

Special Commentary

Mark Vitner, Senior Economist
mark.vitner@wellsfargo.com • (704) 410-3277
Charlie Dougherty, Economist
charles.dougherty@wellsfargo.com • (704) 410-6542
Matthew Honnold, Economic Analyst
matthew.honnold@wellsfargo.com• (704) 410-3059

What's Ahead for Housing in 2019?

Home Sales Weakened in 2018 but Lower Interest Rates Might Spark a Rebound

The housing market lost considerable momentum over the course of 2018. Buyers pulled back as affordability succumbed to years of price gains that have been well in excess of income growth. Higher mortgage rates reduced affordability even further and interest rates rose slightly more than expected. The concerted hawkish rhetoric from the Fed this past fall also likely sent many potential buyers to the sidelines, as Fed officials indicated that the Fed had a long way to go to bring the federal funds rate back to neutral. The weather and natural disasters added to the industry's woes, as unusually wet weather plagued much of the South during the fourth quarter and wildfires in northern and southern California kept potential buyers indoors.

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The decline in buyer sentiment is most evident in the survey data. The proportion of consumers stating now is a good time to buy a home in the Conference Board's Consumer Confidence Survey has steadily trended lower and accurately presaged the slide in new and existing home sales. Somewhat more disturbing has been the slide in homebuilders' expectations for sales over the next six months. We suspect that the December survey was influenced by the persistent selloff in the stock market and concerns that interest rates would likely rise further in 2019. That pessimism seems a bit overdone and there have been a handful of anecdotal reports that buyer traffic has revived a bit now that mortgage rates have fallen back below 4.5%.

We have scaled back our economic forecast slightly for 2019 due to the recent financial market volatility and tightening in credit conditions. Real GDP is now expected to rise 2.6% this year, versus our earlier forecast of 2.7%. We are still looking for the Fed to hike interest rates two times this year but have pushed the first hike out to June and expect the other in December. The financial markets currently have a more cautious view. The bond market and federal funds futures market expect the Fed to remain on hold the entire year. A pause in interest rate increases might help revive the housing market, or, at a minimum, help stem the erosion in home buying experienced during the last nine months of 2018.

Figure 1

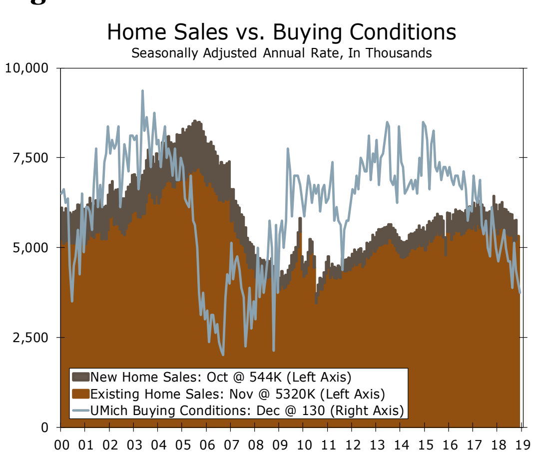
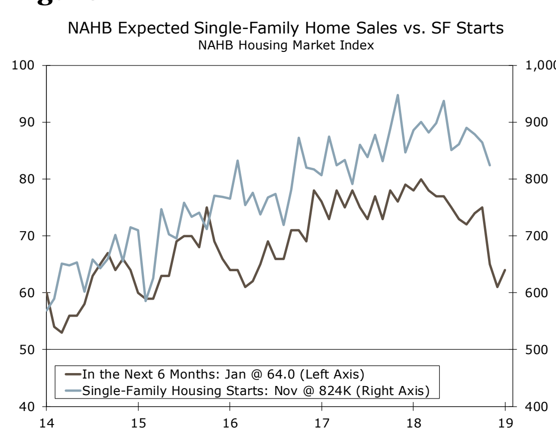


Figure 2



Source: Department of Commerce, National Association of Realtors, University of Michigan, NAHB and Wells Fargo Securities

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Improving Fundamentals Should Eventually Lead to Strong Growth

We believe sentiment on the broader economy and housing market is currently too pessimistic. The economy's underlying fundamentals remain sound, as evidenced by the blowout December employment report, which saw 312,000 net new jobs created during the month and a total of 2.6 million jobs added in 2018. The strength in job growth has corresponded with a pickup in household formation, which is essentially the underlying demand for homes and apartments.

While the underlying demand is improving, affordability remains a formidable hurdle for many households. Home prices have risen much faster than incomes for the past few years, which has caused many renter households to continue to rent. Demand for apartments was surprisingly strong this past year, and vacancy rates remain low across much of the country despite a surge in new completions. Moreover, strong demand for apartments has kept rents climbing, which has made it harder for young families to accumulate savings.

The composition of employment growth also tilted demand more toward rentals than in past cycles. The strongest job growth has tended to be in technology markets, such as the San Francisco Bay area, Seattle and Denver, and a larger share of the jobs created have been in urban areas, where fewer homes are available for sale. Home prices in these metro areas have surged relative to median incomes, and prices finally appear to have risen to a point where buyers have pulled back in a significant way. Businesses and residents in these areas are also increasingly looking to relocate to other parts of the country where home prices are not nearly as high. The increase in relocations should bolster home sales in parts of the country on the receiving end of this trend, including Charlotte, Nashville, Las Vegas, Phoenix, Tampa and Raleigh.

Moderation in home prices and the pullback in mortgage rates should help revive demand in coming months.

Other notable shifts in the market are also acting to cool some of the hottest housing markets. Foreign buying has slowed considerably as global economic growth has weakened and the dollar has strengthened. This has slowed home buying in many key gateway markets, including Los Angeles, New York and Miami. Tax reform, which put limits on the deductibility of mortgage interest and state and local taxes, also appears to be slowing demand for higher priced homes in the Northeast.

We continue to look for modest improvement in new and existing home sales in 2019. The moderation in home prices and pullback in mortgage rates should help revive demand in coming months. We suspect that the unusually wet weather and California wildfires exaggerated the extent to which home sales slowed last fall, and look for a modest rebound in coming months, provided the weather returns to something close to normal. We expect new home sales to rise 1.6%, while existing home sales should edge up 0.6%. Most of the improvement is likely to take place at lower price points, as housing shifts away from higher cost metro areas to lower cost areas. We are also likely to see more lower priced product come to market, both in the first-time buyer market and the retiree market, which has been one of the few areas that has held up well this past year.

Figure 3

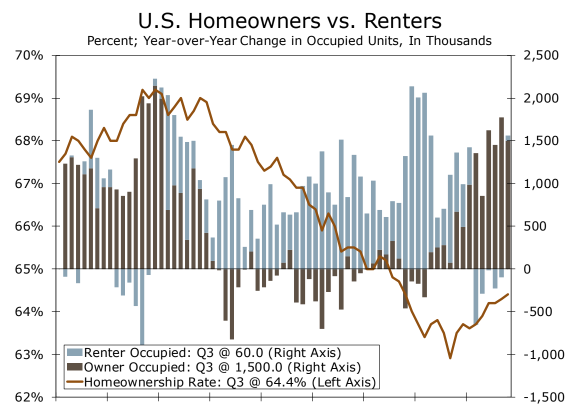
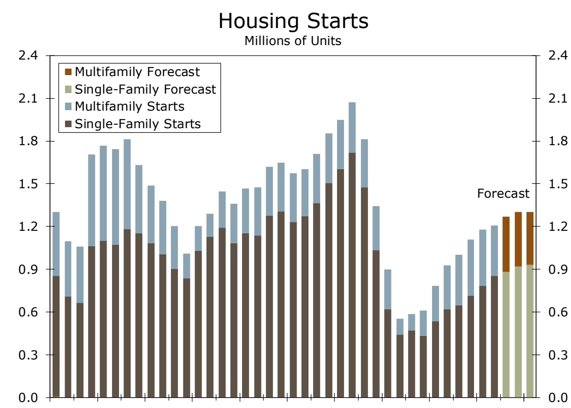


Figure 4



Source: U.S. Department of Commerce and Wells Fargo Securities

National Housing Outlook

	2011	2012	2013	2014	2015	2016	2017	Forecast 2018	2019	2020
Real GDP, Percent Change	1.6	2.2	1.8	2.5	2.9	1.6	2.2	2.9	2.6	2.2
Residential Investment, Percent Change	-0.1	13.0	12.4	3.9	10.1	6.5	3.3	-0.2	-0.8	1.5
Nonfarm Payroll Change (Avg. Monthly)	174	179	192	250	226	195	182	220	168	120
Unemployment Rate	8.9	8.1	7.4	6.2	5.3	4.9	4.4	3.9	3.6	3.3
Home Construction										
Total Housing Starts, in Thousands	608.8	780.6	924.9	1,003.3	1,111.8	1,173.7	1,202.9	1,270.0	1,300.0	1,300.0
Single-Family Starts, in Thousands	430.5	535.3	617.7	647.9	714.5	781.5	848.9	880.0	920.0	930.0
Multifamily Starts, in Thousands	178.3	245.3	307.2	355.4	397.3	392.2	354.0	390.0	380.0	370.0
Home Sales										
New Home Sales, Single-Family, in Thousands	305.0	369.0	429.0	437.0	501.0	561.0	613.0	620.0	630.0	640.0
Total Existing Home Sales, in Thousands	4,260.0	4,660.0	5,090.0	4,940.0	5,250.0	5,450.0	5,510.0	5,430.0	5,465.0	5,485.0
Existing Single-Family Home Sales, in Thousands	3,787.0	4,128.0	4,484.0	4,344.0	4,646.0	4,838.0	4,892.0	4,820.0	4,850.0	4,870.0
Existing Condominium & Co-op, in Thousands	477.0	528.0	603.0	591.0	608.0	614.0	619.0	610.0	615.0	615.0
Home Prices										
Median New Home, $ Thousands	227.2	245.2	268.9	288.5	294.2	307.8	323.1	322.5	326.4	330.9
Percent Change	4.8	7.9	9.7	7.3	2.0	4.6	5.0	-0.2	1.2	1.4
Median Existing Home, $ Thousands	166.1	176.8	197.1	208.3	222.4	233.8	247.2	259.2	271.2	282.0
Percent Change	-3.7	6.4	11.5	5.7	6.8	5.1	5.7	4.9	4.6	4.0
FHFA Purchase Only Index, Percent Change	-4.2	2.9	7.1	5.1	5.4	6.0	6.7	6.4	4.8	4.4
S&P Case-Shiller C-10 Home Price Index, Percent Change	-3.5	0.3	11.7	7.9	4.6	4.5	5.3	5.5	4.5	4.2
Interest Rates - Annual Averages										
Federal Funds Target Rate	0.25	0.25	0.25	0.25	0.27	0.52	1.13	1.96	2.75	2.94
Prime Rate	3.25	3.25	3.25	3.25	3.27	3.52	4.13	4.96	5.75	5.94
10-Year Treasury Note	2.78	1.80	2.35	2.54	2.14	1.84	2.33	2.91	3.14	3.25
Conventional 30-Year Fixed Rate, Commitment Rate	4.46	3.66	3.98	4.17	3.85	3.65	3.99	4.54	4.74	4.85

Forecast as of: January 16, 2019

Source: U.S. Dept. of Commerce, U.S. Dept. of Labor, FRB, FHFA, FHLMC, National Association of Realtors, S&P, Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Abigail Kinnaman	Economic Analyst	(704) 410-1570	abigail.kinnaman@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Donna LaFleur	Executive Assistant	(704) 410-3279	donna.lafleur@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com